



Legislative Audit Division

State of Montana

Report to the Legislature

March 2003

Performance Audit

Highway and Bridge Construction Contract Claims Process

Montana Department of Transportation

This report contains recommendations to improve the process to administer contract claims on highway and bridge construction contracts. Recommendations include:

- ▶ Establishing a management information system so claim activity and impacts can be evaluated.
- ▶ Removing repetitive steps in the claim review process and focusing on earlier negotiations of claims with contractors.
- ▶ Reviewing the value of placing bid documents in escrow and using these documents to negotiate contract claims.
- ▶ Establishing timelines for Board of Contract Appeal reviews of claims.

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March 2003

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Montana Department of Transportation's process to administer claims filed by contractors on highway and bridge construction projects. The audit was requested by the department and approved by the Legislative Audit Committee. A claim is a payment dispute that could not be resolved through the department's regular payment process.

This report contains recommendations for improving the claims process. Responses from the Department of Transportation are contained at the end of the report.

We wish to express our appreciation to the staff of the department and contractors for their cooperation and assistance.

Respectfully submitted,

(Signature on File)

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Performance Audit

Highway and Bridge Construction Contract Claims Process

Montana Department of Transportation

Members of the audit staff involved in this audit were Alexander S. Gulde, Joe Murray, and Jim Nelson.

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Appointed and Administrative Officials

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Bill McChesney, Glendive
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Introduction

A performance audit of the contract claims process was requested by the Montana Department of Transportation (MDT) and approved by the Legislative Audit Committee. Contract claims is the term used to refer to the administrative process to handle disputes between contractors and district staff in performance of a construction contract.

Contract claims are a normal part of the highway and bridge construction process to help the department and contractors address disputes that are not easily resolved and determine if additional compensation to a contractor is warranted. Contract claims are handled outside the normal process of paying contractors. Therefore, it is important to have a contract claim process that is efficient and timely. Department officials requested an audit because they wanted to know:

- How claims impact department and contractor operations.
- If the contract claims process is fair to contractors while still protecting the taxpayer's investment.
- If the department's claims process is efficient and if any changes are needed in the current process.

Contract Claims Are Limited

There are relatively low numbers of contract claims filed and their dollar impact to the department's overall construction program is limited. The department measures total construction costs by tracking payments made to contractors for work performed. One method for assessing the impact claims have on department operations is to compare payments made to contractors to total claims settled for the same time period. MDT information shows the overall impact claims have on the department's overall costs of construction is minimal. The department paid contractors more than \$638 million between fiscal years 1990-00 through 2001-02, but claims amounted to less than one-half of one percent of this total. However, even though claims are a small percentage of total payments, contractors were still paid more than \$3 million in

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additional compensation through claim settlements over the last three years.

Claims Can Affect Individual Projects

Claims can have significant financial impacts on individual projects and contractors. This includes the amount of staff time needed to address claim issues. We reviewed all (25) claims for projects that began construction in calendar years 2000 and 2001. Even though claims have limited impact on the costs of the department's overall construction program, they can significantly impact payments to contractors on individual projects. For example, one project we reviewed has a \$2.5 million dollar claim pending on a \$10.7 million project. This is 23 percent of the contract amount. Contract claims also increase general administrative and indirect costs for both the department and contractors in order to administer them.

Management Information Needed

The department does not have management information that provides for efficient administration of contract claims. Management information related to claim activity should be maintained to manage claim activity in an efficient manner. The department does not track information such as the total number of claims filed in each district, the reasons claims were filed, the amount of time staff spend dealing with claim issues, and the status of claims being reviewed. Presently, the department relies exclusively on Construction Bureau and district staff memory to obtain data related to claims. Consequently, we identified problems with the accuracy of department information related to claim activity and neither the Construction Bureau nor district staff knows the extent or impact of claim activity on the MDT's construction program.

Documentation Could be Improved

Documentation weaknesses in the department's claims process make it difficult to determine how decisions to settle claims are made and whether the settlements are fair to either the state or contractors. Documentation plays a significant role in favorable and timely negotiation and settlement of claims. Therefore, all phases of claim review should be documented and all department decisions supported. We noted several documentation weaknesses related to the claim process. The lack of documentation made it difficult to

determine how and why the department made decisions related to claims. Consequently, it was not always possible to determine how settlements with contractors were reached or if settlements were fair to contractors or the taxpayer.

Coordination Needed

There is limited coordination between the districts, Construction Bureau, and Federal Highway Administration (FHWA) regarding contract claim activity. The Construction Bureau has expertise not available in the districts and is also responsible for ensuring problems on construction projects are handled consistently statewide. Therefore, districts should be immediately notifying the bureau about claim issues. Our review found coordination between the districts and the Construction Bureau on claim issues is limited and inconsistent. Often the Construction Bureau was not notified and included in claim issues until district staff and contractors had spent months trying to resolve an issue. In some cases the Construction Bureau was not aware of contract claims until they were appealed to the Board of Contract Appeals. Insufficient coordination between districts and the Construction Bureau caused consistency and timeliness issues in resolving contract claims.

The FHWA determines whether contract claims are sufficiently supported to receive federal funding participation. Early coordination with the FHWA is necessary so they can determine if they will participate in payment of a claim. MDT district construction staff generally has the responsibility to coordinate claim issues with the FHWA. Of the 25 claims we reviewed, districts initiated early coordination with the FHWA on only 3 claims. In several cases, FHWA officials were not aware of claim issues until late in the claim review process. Claim review and settlement decisions were delayed due to limited coordination between districts and the FHWA.

How Can Contract Claim Administration be Improved?

There are a number of weaknesses in the department's current system to administer contract claims. These weaknesses have reduced the MDT's ability to efficiently administer contract claims. To help improve its ability to administer contract claims the department should establish a database to compile and analyze

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management information related to claim activity, train staff regarding claim documentation requirements, and establish a quality control process that includes claim file review to ensure claims are properly documented.

Contract Claim Evaluation and Settlement

We reviewed the timeliness of the claims process from the date a claim issue was first brought to a district's attention until final resolution. It takes the department approximately 90 to 270 days to process a claim. For the 25 claims we reviewed, the districts took an average of 130 days to review claims. The current claims review process has repetitive steps that contribute to inefficiencies in processing claims. Specifications currently require contractors to notify districts of claim issues three different times. We noted there was little difference in the information provided during these three steps. Additionally, district staff must respond to each notification and we found denials were generally for the same reason each time.

Formal negotiations with contractors should begin early in the claims process because the more time that passes the larger the disagreements become and the more difficult it becomes to reach a settlement. During our review, we noted any negotiations with contractors tend to occur during the latter stages of the claims process and after districts already denied issues at least twice. Since negotiations occur late in the claim process, the effectiveness of the claims process is reduced because an adversarial relationship has generally developed between the district and contractor. This makes negotiations and claim resolution more difficult. To improve the timeliness and effectiveness of the claim process, the department should eliminate repetitive steps from the claim process and focus on early negotiations of claim issues with contractors.

Escrowed Bid Documents

Construction contracts of at least \$3 million include a special provision that requires bid documents be placed in escrow within seven days of the bid opening. In the event a contractor files a claim on a project, the special provision allows the department to open and review the escrowed documents and use the information when negotiating the claim with the contractor. Construction contracts state that if contractors do not submit all bid documentation to be

placed in escrow it is considered a “material breach” of the contract and acts as a “final and total waiver” of the claim. We identified instances where all bid documentation was not provided as required, but claims were not denied. There is inconsistent support among department staff on whether placing bid documents in escrow is valuable to the contract claims process. The department needs to review the value of placing bid documents in escrow. If they determine the value is limited then the requirement should be eliminated. If the department decides to continue the practice, a process should be established to ensure contractors provide all required documentation.

Board of Contract Appeals

The Board of Contract Appeals (i.e. the board) becomes involved in the claims process when claims are denied at the district level. If contractors disagree with a district’s decision to deny a claim, the decision can be appealed to the board. The board reviews the documentation related to the claim and the reason the district denied it. The board can uphold the district’s decision or modify the decision in whole or in part.

The Board of Contract Appeals Works as Intended

The department requested an assessment on whether the board was making fair, unbiased decisions when evaluating claims. The department also wanted an evaluation of potential alternatives to the board. Alternatives to the board are available. However, these alternative approaches can be more extensive and expensive than an internal review board. We did not find evidence the board was making decisions that were not fair or were biased in any way. The department’s process to use an internal Board of Contract Appeals is working as intended and a change to an alternative approach is not warranted.

Board of Contract Appeals Needs to Establish Review Timelines

Our review found the board was not reviewing claims in a timely manner. On average, it takes the board 147 days to review claims that were appealed. The department’s Specifications for Road and Bridge Construction establish timelines for other phases of the claim process, but do not require the board to review claims within any specified period of time. The department should establish timelines

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for Board of Contract Appeal reviews in the Standard Specifications
for Road and Bridge Construction.

Chapter I - Introduction

Introduction

A performance audit of the contract claims process was requested by the Montana Department of Transportation (MDT) and approved by the Legislative Audit Committee. Contract claims is the term used to refer to the administrative process followed to handle disputes between contractors and district staff to help reach a final decision on whether additional compensation to a contractor is warranted in performance of a construction contract. Contract claims are handled outside the normal process of paying contractors. This report presents the findings of our performance audit of MDT's process to administer contract claims.

Audit Objectives

Preliminary planning work was conducted to gain an understanding of the contract claims process. In addition to providing MDT officials and the legislature with information related to processing contract claims on construction projects, we developed the following audit objectives:

- ▶ Determine if controls exist to minimize contract claims.
- ▶ Determine if sufficient controls exist to process contract claims efficiently.
- ▶ Determine how contract claims impact both department and contractor operations.
- ▶ Determine if changes are needed in the established contract claims process.

Audit Scope and Methodology

This audit provides information on the Montana Department of Transportation's process to review claims on highway and bridge construction projects. To gain an understanding of the contract claims process, we interviewed department management and staff in both Helena and in the field. We also interviewed officials from the Federal Highway Administration (FHWA). We examined state and federal laws and rules related to the claims process, the department's strategic plan and goals and objectives, the department's construction manual, and the department's specifications for road and bridge construction. We also completed file reviews of construction projects that had claim activity. This preliminary work helped us

Chapter I - Introduction

develop an understanding of the contract claims process and the respective duties of the Construction Bureau, the districts, and the FHWA in processing contract claims.

File Reviews and Observations

After completing planning work, the main focus of our fieldwork was directed at file reviews of construction projects and documentation related to claim activity that occurred on these projects. We reviewed all reported claim activity for projects that began construction during calendar years 2000 and 2001. Since the department (i.e. Construction Bureau) does not centrally maintain information related to the department's overall claim activity, we obtained information regarding claims from the five MDT districts. File reviews were completed at field offices and at the Construction Bureau. All documentation related to claim activity was examined. We also reviewed daily diaries of project managers to further evaluate the circumstances surrounding each claim. Daily diaries are a project manager's record of construction activities including potential problems and discussions with contractors. In all, we reviewed 25 claims on 20 construction projects. We also attended a meeting of the department's Board of Contract Appeals to observe their procedures for reviewing district claim decisions that were appealed.

Follow-up Interviews

We conducted follow-up interviews with MDT management and staff at the completion of our file reviews. Department staff interviewed included officials from the Construction Bureau, District Administrators, District Construction Engineers, Project Managers, members of the Board of Contract Appeals, and staff from the department's legal services unit. We also completed follow-up interviews as necessary with officials from the FHWA. Additionally, we interviewed officials from the Montana Contractors Association and 10 highway and bridge construction contractors to gather input and suggestions regarding potential improvements made to the process.

Criteria

Criteria to evaluate the claims process was obtained from a variety of sources. We reviewed the department's construction manual and

Standard Specifications for Road and Bridge Construction that outline the procedures for processing contract claims. In addition, we reviewed federal regulations and information from the FHWA. Information was also gathered from several other sources including the American Society of Civil Engineers, the National Construction Dispute Resolution Committee, the American Arbitration Association, and the Dispute Review Board Foundation. Transportation departments in four other states (Colorado, Idaho, Washington, and Wyoming) were contacted to discuss procedures for processing claims. In addition, we interviewed officials from the Architecture and Engineering Division (Department of Administration) and the Water Resources Division (Department of Natural Resource and Conservation) regarding claims processing for building and dam construction projects. The information from these varied sources was used to compare to MDT's process and identify potential efficiencies that could be incorporated.

Compliance

We reviewed compliance with state and federal laws and rules related to contract claims. There are no specific laws related to highway and bridge construction contract claims. However, statutes related to public contracts do apply to highway and bridge construction projects and claims filed on those projects. A major requirement of these statutes is that the department must pay interest on claims from the date they were filed and pay all attorney fees for the contractor if a district court rules in favor of a contractor on a claim. During the audit period, no claims were filed in court so we could not test compliance with this law.

We noted instances where the department is not in compliance with federal rules related to processing contract claims. Areas of noncompliance related to claim documentation, timeliness of the claims process, and department coordination with the Federal Highway Administration. These issues are discussed in chapter III.

Potential Issues for Further Study

During the course of our review, we identified two areas outside the scope of our audit with potential for further study.

Chapter I - Introduction

Engineering Oversight Bureau

The Engineering Oversight Bureau (EOB) within the department's Engineering Division was created in 1999 because MDT officials believed there was a need for additional oversight of construction projects. According to EOB officials, the bureau is responsible for reviewing and evaluating construction activities on active construction projects, completing plan reviews of projects in the design phase, conducting formal post-construction reviews, and developing and performing selected training for field construction staff. During the audit, department staff indicated some EOB activities duplicate Construction Bureau activities. Other concerns/comments included limited communication and coordination between the EOB and the Construction Bureau, EOB staff assuming authority of project managers on construction projects, and limited use of EOB reviews. A performance audit could review the role of the EOB and determine how its operations could be improved.

Highway and Road Design Administration

We noted a common cause for change orders and claims was the inaccuracy and incompleteness of plans and designs used on construction projects. Department information shows there has been a significant increase in the number and cost of change orders over the last few years. In fiscal year 1997-98, there were 253 change orders totaling \$4.8 million (approximately 3 percent of contractor payments). Information obtained during this audit showed during fiscal year 2001-02 there were 303 change orders totaling \$17.7 million (approximately 8 percent of contractor payments). Some of this increase might be attributable to the department having a larger construction program. However, some of the increase might also be attributable to a less stringent change order approval process, increasing numbers of design errors, increasing use of consultants to design projects, or a combination of these issues.

A performance audit could evaluate the reasons for this increase in change order activity. This could include analysis of the department's procedures to review the accuracy of plans and its process to review and approve change orders. A performance audit could also include an assessment to determine if the numbers of plan

errors and change orders is high when compared to industry standards and the overall impact change orders have on the construction process.

Report Organization

The remainder of this report is divided into two chapters. Chapter II provides general background information on MDT's organization, contract claims, and the department's process to evaluate claims. Findings and recommendations to improve the contract claims process are discussed in Chapter III.

Chapter II - Background

Introduction

According to section 60-2-201, MCA, the Montana Department of Transportation (MDT) is the custodian of the federal-aid and state highway systems. General powers outlined in statute include planning, altering, constructing, reconstructing, and improving the state's highways and bridges. Department officials set a goal to construct safe, cost-effective highway improvement projects, while utilizing all available federal funding. Highway and bridge construction is achieved by contracting with private contractors to complete designated projects through a competitive bidding process. MDT is responsible for monitoring construction contractors to ensure projects are completed as required by the contract. One component of administering construction contracts is processing and resolving contract claims.

This chapter provides information related to the contract claims process for highway and bridge construction projects. The following sections describe Contract Claims and the role of the Construction Bureau, MDT districts, and the Federal Highway Administration (FHWA) in the claims process.

Change Orders and Contract Claims

Change orders and contract claims are an integral part of highway and bridge construction. Change orders are modifications to construction contracts that reflect conditions not anticipated during the project's planning process. In most situations, the department and contractors are able to come to an agreement on additional work and compensation related to contract deviations. Occasionally, however, an agreement between the two parties cannot be reached. Contract claims is the administrative process followed to handle disagreements between contractors and district staff to reach a decision on whether additional compensation to a contractor is warranted. According to the FHWA, if contract claims are not administered appropriately the result can be delays in project completion and a costly resolution process that does not benefit contractors or the department.

Why do Claims Occur?

There are several reasons claims occur on construction projects including changes in conditions within the construction area, design

Chapter II - Background

changes, unclear specifications, changes in quantities of materials used on a project, or work delays or accelerations. The following provides examples of situations that may result in claims. Some examples were identified during our file reviews and others came from discussions with MDT staff and contractors.

- ▶ Contractors encountered soil conditions they did not expect because they were not provided the soil information by the department. The department recently decided to once again put soil-testing data on future plans to help reduce this kind of problem.
- ▶ Differences in design approaches between department and consultant designs make understanding and interpreting plan requirements more difficult for contractors.
- ▶ Substantial increases in federal funding for highway and bridge construction resulting in more projects being designed with no increases in resources to review projects prior to going to bid.
- ▶ Department and contractor personnel interpret construction specifications or special provisions included in the contract differently.
- ▶ Less experienced department staff managing construction projects.
- ▶ Personality conflicts between department staff and contractors reduced the ability of department and contractor staff to resolve some issues.
- ▶ Unexpected weather changes or changes in site conditions on the construction project.
- ▶ Contractors using ineffective project management, poor scheduling, or substandard work.

Department Organization

Responsibility for administering highway and bridge construction projects and processing contract claims lies with the department's Construction Bureau (in Helena) and five district offices around the state.

Construction Bureau

The Construction Bureau is located within MDT's Engineering Division and is responsible for day-to-day construction activities

Chapter II - Background

after construction projects are awarded. The bureau consists of 22 FTE including a Bureau Chief who administers bureau operations. Examples of major construction-related duties of the bureau include:

- ▶ Developing policies and procedures for contract administration.
- ▶ Maintaining the department's construction manual.
- ▶ Developing specifications for highway and bridge construction.
- ▶ Evaluating new construction methods/procedures.
- ▶ Advising district staff on construction practices and problems.
- ▶ Processing monthly payments to contractors.
- ▶ Approving project change orders above \$10,000.
- ▶ Resolving contractor claims that reach impasse or litigation.

District Offices

MDT's organizational structure includes five district offices around the state. District offices are located in Billings, Butte, Glendive, Great Falls, and Missoula. Direct administration of construction projects occurs at the district level. There are approximately 346 FTE allocated to the districts to oversee and monitor construction activities. District staff responsible for administering construction activities includes District Administrators, District Construction Engineers, Assistant District Construction Engineers, and Project Managers. District Administrators oversee all transportation functions within their district, including construction activities.

Each district has a District Construction Engineer who is the primary source of direction for the proper administration of construction contracts. Their responsibilities include administering the district's construction operating budget, monitoring use of manpower, supervising field staff assigned to oversee construction projects, and advising staff on problems that arise on those projects. Assistant District Construction Engineers help District Construction Engineers with their duties and responsibilities.

Engineering Project Managers provide day-to-day on-site management of construction projects. Project managers are responsible for evaluating and documenting contractor compliance with contract requirements, preparing estimates for contractor

Chapter II - Background

payments, interpreting plans and specifications, and initiating and preparing necessary change orders. They are the first point of contact for contractors to discuss and work out problems that arise on construction projects. This includes approving or denying deviations from contract requirements that could result in contractors requesting additional compensation. Crews who perform office, surveying, inspecting and materials testing duties assist project managers. The size and make-up of each crew varies depending on the size and type of construction project.

What Role Does FHWA Play in the Claims Process?

Federal regulations (23 CFR 635.124) outline requirements related to federal participation in contract awards and settlements. The primary role of the Federal Highway Administration (FHWA) related to contract claims is to determine whether claims are sufficiently supported to receive federal funding participation. For example, if the federal participation for the original contract was 80 percent, the FHWA will pay for 80 percent of the claim if they agree with it. The FHWA will not participate in “extraneous” costs associated with claims, such as legal fees. Department policy and federal regulations require the MDT keep the FHWA officials informed of all claims by providing them with copies of claim forms and supporting documentation in order to ensure federal participation on a claim.

How Does MDT's Claim Process Work?

The department's procedures to process claims are outlined in section 105.16 of the department's Standard Specifications for Road and Bridge Construction. MDT and contractors share responsibility for moving claims through the process. Contractors have a responsibility to immediately notify project managers when a potential problem, dispute or disagreement exists that could result in a request for additional compensation. Contractors must also provide sufficient documentation to the department to support their contentions. Department staff has the responsibility to ensure contractors provide all necessary documentation, review this information, and conduct meetings with contractors to discuss the issue. Department staff must also decide whether to approve or deny a claim based on their review of the documentation and discussions

with contractors. This decision should be made within the timeframes provided for in the specifications. The following sections briefly describe the claims review process (as outlined in the department's specifications) and types of documentation required.

Initial Written Notification

Upon discovery of a potential problem that could result in a request for additional compensation, contract time extension, or other contract change, contractors must immediately notify the project manager in writing. The written request must fully explain the situation and why additional compensation, time extension, or contract change is warranted. A project manager must issue a decision to the contractor within seven calendar days of the receipt of this notification. If a decision cannot be made within seven days, the project manager must notify the contractor (in writing) that an additional seven days is needed to respond to the contractor's request. If a project manager does not respond to a contractor's written notification, it is considered a denial of the contractor's request.

Notice of Potential Claim

If a contractor disagrees with a project manager's decision on the written notification, the contractor has seven days to submit a fully completed notice of potential claim (NOPC) form. The NOPC is used to state the contractor's objections to the project manager's response to the written notice, reiterate the basis for and amount of any additional compensation, and present possible remedies. Contractors must also allow the project manager access to and provide copies of all records to support additional costs. Project managers have seven days to respond to the NOPC and not responding is considered a denial.

Certified Claim

If the project manager again denies the claim, the next step in the process is for the contractor to submit a certified claim to the project manager. A certified claim stipulates the claim is "not false, fictitious, or fraudulent" and must be submitted using the department's certified claim form. Certified claims must be submitted within 30 days of the department's denial of the NOPC. The certified claim must specify all reasons for the claim and include

Chapter II - Background

all cost records associated with the claim and any additional information pertinent to the claim. Claim updates must be submitted every 30 days until a contractor has incurred all costs or the department approves the claim. District administrators make the final decision on whether to approve a certified claim. If a district administrator issues a written decision on a claim, it must be issued within 30 days of receipt of the certified claim. A contractor's claim is also deemed denied if a district administrator does not respond to the certified claim.

Board of Contract Appeals

Contractors can appeal a district's decision to deny a certified claim to the department's Board of Contract Appeals (i.e. the board). The board consists of MDT's Chief Engineer, Operations Engineer, and Chief Legal Counsel. The Construction Bureau Chief serves as the board's secretary and is responsible for scheduling board meetings and ensuring board members are provided copies of all documentation related to a claim. The board has a responsibility to evaluate the claim, review the district's decision to deny the claim, and make a decision on the validity of the claim and the district's decision. The board only reviews those documents and evidence submitted with the original claim and the district's evaluation of the claim. If additional information is needed to help it make a decision, the board can request the information from the district or the contractor. The board may affirm, overrule, or modify, in whole or in part, the district's decision. The board's decision is final. If contractors want to continue pursuing a claim issue, they can pursue the claim in district court.

Chapter III - Contract Claims Administration

Introduction

Contract claims will always be part of the highway and bridge construction process to help the department and contractors address disputes that are not easily resolved, and determine whether additional compensation to a contractor is warranted. Therefore, it is important to have a claims process that is efficient and timely. Department officials requested an audit of contract claims because they wanted to know how claims impact both department and contractor operations. Specifically, they wanted to know if the contract claims process is fair to contractors while still protecting the taxpayer's investment. They also had questions regarding how efficiently the department processes claims and if any changes were needed in their established process. Department management also believed the number of contract claims filed was increasing and requiring more staff time to resolve the issues. This chapter discusses the department's process to administer contract claims.

What Impact do Claims Have on the Department and Contractors?

Based on department information, we found there are not high numbers of contract claims and the impact they have on the department's overall construction costs is limited. However, there are financial impacts on individual projects and contractors. There are also general administrative and indirect costs for both the department and contractors to administer contract claims.

The department measures total construction costs by tracking payments made to contractors for work performed. One method for assessing the impact claims have on department operations is to compare payments made to contractors to total claims settled for the same time period. This comparison is provided in the following table for fiscal years 1999-00 through 2001-02.

Chapter III - Contract Claims Administration

Table 1			
<u>Comparison of Contractor Payments to Settled Claims</u>			
FY 1999-00 through 2001-02			
<u>Fiscal Year</u>	<u>Contractor Payments</u>	<u>Claim Settlements</u>	<u>Percentage of Payments</u>
1999-00	\$ 227,422,273	\$ 958,156	.42%
2000-01	\$ 198,228,507	\$ 272,647	.14%
2001-02	<u>\$ 213,001,207</u>	<u>\$ 1,807,110</u>	<u>.85%</u>
Total	\$ 638, 651,987	\$ 3,037,913	.48%

Source: Compiled by the Legislative Audit Division from department records.

Based on Montana Department of Transportation (MDT) data, the overall impact (as a percentage) claims have on total payments made to contractors is limited. Claim activity has had minimal impact on the department's overall costs of construction. While the department paid contractors more than \$638 million over the last three years, claims amounted to less than one-half of one percent of this total. However, even though claims are a small percentage of total payments, contractors were still paid more than \$3 million in additional compensation through claim settlements over the last three years. This does not include additional compensation made through change orders.

Claims Can Increase Costs for Individual Contracts

To further assess claim activity and its impacts, we reviewed claim activity on a project-by-project basis. To do this, we reviewed all claims (25) for projects that began construction in calendar years 2000 and 2001. We noted that even though claims have had limited impact on the costs of the department's overall construction program, claims can significantly impact payments to contractors on individual projects. For example, we identified a claim the department settled for \$160,000 on a project with a contract award of just over \$1 million. While this dollar amount is not significant when compared to the department's overall construction costs, it is 16 percent of the contract amount for this individual project. Another project we reviewed has a \$2.5 million claim pending

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review on a \$10.7 million project. This is 23 percent of the contract amount. According to contractors, another effect of contract claims are delays in settling claims with the department because this increases the financial impacts to contractor operations. Similar to the department, contractors also experience administrative costs related to contract claims.

According to MDT officials, another major impact of claim activity is that it is a “time waster” for department staff. Specifically, they said dealing with claim issues reduces the staff’s ability to effectively manage construction projects and also takes staff time away from performing other tasks.

Conclusion:

- ▶ There are relatively low numbers of contract claims filed and their dollar impact to the department’s overall construction program is limited.
- ▶ Claims can have significant financial impacts on individual projects and contractors. This includes the amount of staff time needed to address claim issues.

MDT Does Not Know the Extent of Claim Activity

Department information related to claim activity is generally limited to claims the department settled by paying additional compensation to contractors. Information such as the total number of claims filed in each district, the reasons claims were filed, the amount of time staff spend dealing with claim issues, and the status of claims being reviewed are not tracked. Department policies require settled claims to be paid and payments recorded on the Construction Bureau’s change order system. However, we also found inconsistencies in how the MDT classifies settled claims. We noted some settled claims are recorded on the change order system as “administrative settlements” but others are recorded as regular change orders. There is currently no formalized or standardized information available at the Construction Bureau or the district-level regarding the department’s claim activity. Presently, the department relies

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exclusively on Construction Bureau and district staff memory to obtain data related to claims.

According to the American Society of Civil Engineers (ASCE), management information related to claim activity should be available to show “what happened, when it happened, why it happened, who caused it to happen, and what was done about it.”

Reliability of MDT Claim Information is Questionable

Since the department did not have centralized management information related to claim activity, we obtained information from each district. Construction Bureau officials believed the districts would be the best source of information since they are directly responsible for administering construction projects.

We compared the initial district information to the data gathered during our file reviews. Based on our analysis, we identified a number of instances where claim information was incorrectly reported. For example, we identified claims during our file reviews that were not reported by district staff. We also found instances where district personnel overstated the number of claims occurring on projects. For example, one district reported eight claims on a single project but when we reviewed the file for this project we only identified two claims. This may be a situation where district staff confused other discussions with the contractor as claim activity or it could be a problem with the district’s documentation related to the claim. In another example, district staff reported a change order as a claim on a project for a work delay caused by the Forest Service shutting down construction activities during the 2000 fire season. District staff said they reported this situation as a claim because they believed the contractor would have filed a claim if the department had not approved the change order.

Extent and True Impact of Claim Activity is Unknown

Neither the Construction Bureau nor district staff know the extent of the department’s claim activity or what the impact of claims are on MDT’s construction program. Most department management and staff we interviewed indicated claims have significant impacts on the

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construction program and believe the number of contractor claims is increasing. However, information we obtained from the districts and the Construction Bureau showed that claims do not have a major impact on the department's construction program. The department's current view of claim activity and its impacts are generally based on perception. This could be due to the significant increase in change order activity in recent years. For example, in fiscal year 1997-98 there were 253 change orders totaling \$4.8 million compared to fiscal year 2001-02 when 303 change orders were approved totaling \$17.7 million.

We noted transportation departments in some other states we contacted maintain more comprehensive management information related to claim activity. For example, the State of Washington uses an electronic database to track the number of claims, the reasons claims occurred, and how they were resolved. Officials from the Washington Department of Transportation indicated this information assists them in directing efforts to correct problems that contributed to claim activity, such as poorly written specifications or vague contract language. More importantly, however, they said the system helped ensure more consistent administration of claim issues on a statewide basis.

Conclusion:

The department does not have management information that provides for efficient administration of contract claims.

Contract Claims Should be Better Documented

The department's construction manual and the Standard Specifications for Road and Bridge Construction require all phases of the claims review process be documented and all department decisions supported. Documentation required includes:

- ▶ Written correspondence between contractors and district personnel.
- ▶ Written summaries of meetings between contractors and department staff.

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- ▶ Notice of potential claim forms.
- ▶ Certified claim forms.
- ▶ Financial records provided by contractors that support their request for additional compensation and review of this information by MDT staff.
- ▶ Project manager daily diaries to record daily activities on construction projects, including discussions with contractors and potential problems that could lead to claims.

The ASCE notes documentation plays the most significant role in the favorable and timely negotiation and settlement of claims. Federal regulations also require documentation be sufficient to support all actions taken on claims. According to the Federal Highway Administration, the “burden of proof” to document the reasonableness of a claim is vested with state transportation agencies. For this reason, MDT legal officials stated all activity related to contract claims should be “clearly and fully” documented in order to defend department actions.

Documentation Weaknesses Identified

We noted a number of weaknesses related to the extent of documentation for contract claims. Examples of documentation weaknesses we noted included:

- ▶ Missing letters from contractors notifying the project manager of the issue, missing notice of potential claim forms, and missing certified claim forms.
- ▶ Incomplete documentation provided by contractors or missing contractor documentation related to equipment and labor costs.
- ▶ Evidence did not always exist indicating contractor documentation supporting the claim was reviewed and verified by district staff as required by the FHWA.
- ▶ Claim documents, such as the certified claim, did not always indicate how much additional compensation was being requested.

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- ▶ Meetings and/or discussions held between the contractor and district staff, and decisions made at these meetings were often not documented.
- ▶ Missing documentation which indicated contractors are kept up-to-date on the status of claims and informing them additional time is needed to review documentation and make a decision.
- ▶ Project managers were inconsistent in maintaining daily diaries related to claim issues. Some diaries provided significant detail related to claim issues and other diaries did not contain any information.

The lack of documentation often made it difficult to determine how and why the department made decisions related to claims.

Consequently, it was not always possible to determine how settlements with contractors were reached or if settlements were fair to contractors or the taxpayer. For example, one project we reviewed had a claim settlement with a contractor for \$160,000. District personnel told us the settlement was based on the amount of work the contractor completed and their “feeling” the settlement was fair. However, documentation associated with the claim did not indicate how much additional compensation the contractor originally requested. The information also did not support the district’s decision to settle with the contractor for \$160,000.

Conclusion:

Documentation weaknesses in the department’s claims process make it difficult to determine how decisions to settle claims are made and whether the settlements are fair to either the state or contractors.

Limited Coordination Between Districts and the Construction Bureau

During the audit, we found contract claim coordination between the districts and the Construction Bureau is limited and inconsistent among district staff. When districts did involve the bureau, it was often not until the districts and contractors had spent months trying to resolve an issue. According to the department’s construction manual, a responsibility of the bureau is to assist districts in resolving contract claims, and districts should involve the bureau as soon as potential claim issues are identified. The Construction

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Bureau has expertise that is not available in the districts, so they serve as a resource for district staff in settling claim issues. The bureau is also responsible for ensuring problems are handled consistently statewide and that changes are made to contracts and specifications to help prevent similar problems in the future.

The construction manual also requires coordination between the districts and the Construction Bureau. For example, the manual states the Construction Bureau is to advise district staff on how to resolve construction problems. In addition, the manual requires districts to submit copies of all claim documentation to the Construction Bureau so it can help districts resolve contractor claims. Our file reviews found the Construction Bureau is not always provided copies of claim documentation and the bureau is often not aware that claims had been filed on projects.

Insufficient coordination between the districts and the Construction Bureau has caused consistency and timeliness issues. For example, we reviewed a claim that was denied by a district and appealed to the Board of Contract Appeals. Between the district and board review the claim took approximately nine months (261 days) to process. The board reversed the district's decision to deny the claim. Construction Bureau officials were not aware of this claim until it was appealed to the board. Bureau officials said they would have recommended the district settle this claim. Had the district coordinated this issue with the Construction Bureau, this claim could have been resolved much earlier.

Limited Coordination Between Districts and the FHWA

Our audit work found coordination with the FHWA is limited. For the 25 claims we reviewed, districts initiated early coordination with the FHWA on only 3 claims. Districts provided the FHWA with claim documentation on three other projects, but it was not until late in the claims process. For example, on one claim we reviewed the FHWA was unaware of the situation until the issue was appealed to the Board of Contract Appeals. The remaining 19 projects we reviewed did not have evidence of any coordination with the FHWA.

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The FHWA will participate in payment of claims if they believe a claim issue is valid. Federal regulations require state transportation agencies to inform the FHWA of claims early in the process so they can determine whether they will participate in payment of a claim. The department has established procedures to coordinate with the FHWA by providing them with copies of claim documentation, such as notice of potential claims and certified claims. Since claims begin at the district level, department procedures require the districts initiate coordination with the FHWA. However, these coordination procedures have not been followed for most claims.

Contractors and district personnel cited frustration that FHWA officials were often not at meetings between district staff and contractors to discuss settlement of claim issues. They said this affected settlement discussions because they did not know for sure if the FHWA would be willing to participate in the claim. If FHWA officials did attend meetings, district staff and contractors said federal officials would often not commit to participation in the claim. According to district staff and contractors, this delayed settlement decisions on claims. FHWA officials indicated these situations generally occurred because the districts either did not inform them of the claim situation or informed them too late in the process to review documentation related to the claim.

The department invites FHWA officials to all meetings of the Board of Contract Appeals. Our observation of board meetings found the FHWA is attending board meetings. However, this is the last step in the process and our observations and interviews with FHWA officials found this is often the first time federal officials were aware of the claim issue. Interviews with district staff found early coordination with the FHWA is not a priority for staff because it requires a significant amount of paperwork to be copied and provided to FHWA officials. District staff said their workloads did not always allow enough time to do this or other job duties were more important. Another reason districts are reluctant to coordinate with the Construction Bureau and the FHWA is because of a sense of responsibility to resolve issues on their own. While the construction

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manual places initial responsibility to resolve claims with the districts, the manual also requires districts to coordinate claims with the Construction Bureau and the FHWA.

Conclusion:

There is limited coordination between the districts, Construction Bureau and the FHWA regarding contract claim activity.

How Can Contract Claim Administration be Improved?

As described in the previous sections, there are a number of weaknesses in the department's current system to administer contract claims. These weaknesses have reduced the department's ability to efficiently administer contract claims. The following sections discuss changes that could be made to improve the process.

MDT Should Compile Information of Claim Activity

Our audit found the department is maintaining limited information related to claim activity and the information it has is not reliable. The American Society of Civil Engineers recommends data be available that provides management with information on the extent of claim activity. This information should be detailed enough to inform management of the reasons claims are occurring, the costs associated with claims, the number of claims, and how claim situations are resolved. In order to better manage claims and assess the overall impacts they have, the department needs to compile more formalized information regarding claims.

Training is Needed

There are a number of reasons for the documentation problems we identified. One reason is lax record keeping by district personnel in maintaining project files. We also determined there are a number of staff that are not familiar with all the requirements for administering contract claims. Interviews with project managers determined they were not always familiar with the importance of documentation and they had differing interpretations of the documentation requirements outlined in the specifications and the department's construction manual. According to MDT officials, many of these staff members are new and have limited experience in administering construction projects and reviewing claims. MDT officials said often times issues become claims because project managers lack experience to identify

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problems early on and address them before they become larger problems. Since problems were not identified at an early stage, documentation regarding the problem is often not obtained. Several project managers we interviewed also had limited experience in handling contract claims and the claims we reviewed were often the project manager's first claim. Project managers and department management indicated staff has received virtually no formal training related to contract claims administration.

Claim Database and Claim Response Team Could Improve Coordination

Establishment of a system to improve coordination between districts, the Construction Bureau, and the FHWA is needed but has historically not been a priority for the department. According to Construction Bureau officials, preliminary steps are being taken to address this issue. For example, the department is working on establishing a Claim Response Team (CRT) that would consist of members from MDT's legal services, the Construction Bureau, district staff, and FHWA personnel. The CRT would be responsible for reviewing large claims and ensuring all "decision makers" are involved in the process to resolve the issue.

The Construction Bureau is also considering development of a claims database to help the department better track claim activity on a statewide basis. According to Construction Bureau officials, the database would also be used to store data on claims and provide the department with the ability to resolve future claim issues and identify staff training needs. Bureau officials also believe the database has potential to create a more efficient system for districts to coordinate claim issues with the Construction Bureau and the FHWA by prompting them when claim issues are identified.

Establishing a claims database and the CRT would provide a means for department staff (both in Helena and the districts) to have access to information on all claim activity that is occurring. It would also provide more timely information to the Construction Bureau to provide assistance to districts and begin addressing problems that caused the claim. The database and CRT could also help ensure the FHWA is notified of claims earlier in the process. Development and

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implementation of the CRT and the claims database needs to become a priority to help improve coordination between MDT districts, the Construction Bureau, and the FHWA.

Establish a Quality Control Process

The MDT utilizes a decentralized organizational structure so district operations are relatively autonomous. There is currently no quality assurance process in place to ensure claims are properly documented and the claims process is working as intended. During our file reviews, we noted MDT's Engineering Oversight Bureau (EOB) conducts reviews of active construction projects. At the conclusion of each review, a report is issued discussing the extent of work completed, construction activities taking place, and comments made by project managers and staff regarding their opinions on how well projects are progressing. The reports also note those areas where projects are being properly managed and areas where improvements are needed. We noted, however, that EOB staff does not include an assessment of how claims are being administered as part of their reviews of construction projects. EOB reviews could be used as a quality assurance tool to ensure district staff is properly documenting the claims process. Information from EOB reviews could also be used to help identify staff training needs related to contract claims administration.

Recommendation #1

We recommend the department:

- A. Establish a database to compile management information regarding contract claims activity.**
- B. Train staff regarding claim documentation requirements.**
- C. Analyze the data collected to determine:**
 - the number of claims filed statewide and by district**
 - the reason claims were filed**
 - which contractors are filing claims**
 - claim cost and status**
- D. Establish a quality control process that includes claim file review to ensure claims are properly documented and valid.**

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Contract Claim Evaluation and Settlement

Most of the department's time and effort related to claims is evaluating the validity of the claim to determine if contractors should be paid additional compensation (i.e. claim settlement). MDT officials had concerns the contract claims process was not working as efficiently as it should. Many of these concerns stemmed from complaints received from contractors regarding the length of time it takes the department to make decisions on whether or not to approve claims. The driving force of contract claims administration is the department's Standard Specifications for Road and Bridge Construction. The specifications become part of every construction contract and define how the process should work and the responsibilities and expectations of both the department and contractors in the claims process. The following sections discuss the department's process to evaluate and settle claim issues.

Most Claims Settled at District Level

We reviewed claim activity for projects that began construction during calendar years 2000 and 2001. We reviewed 25 claims and noted 12 claims were settled, 10 claims were denied, and 3 were still being reviewed. No claims were pursued in district court. Overall, the districts either settled or denied 19 of the 22 (86 percent) finalized claims we reviewed.

How Long Does the Current Process Take?

One focus of our audit was reviewing the timeliness of the claims process from the date a claim issue is first brought to the district's attention until final resolution. We defined final resolution as either approval or denial of a claim by district personnel or by the Board of Contract Appeals. It takes the department approximately 90 to 270 days to process a claim. For the 25 claims we reviewed, the districts took an average of 130 days to review claims. The timeframes related to Board of Contract Appeal reviews are discussed later in this chapter.

Eliminate Repetitive Steps at District Level

We noted the current claims review process has some repetitive steps that contribute to inefficiencies in processing claims. Specifications currently require contractors to notify districts of claim issues three different times before final decisions are made on claims. This includes:

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- ▶ Notifying project managers in writing describing a problem or disagreement (i.e. potential claim situation) that could result in additional compensation being requested.
- ▶ Submitting a notice of potential claim (NOPC) if the first written request is denied or ignored.
- ▶ Submitting a certified claim to district staff after a NOPC is denied to certify a claim is not false, fictitious, or fraudulent.

We noted little difference in the information provided in the initial written notification, the NOPC, and the certified claim. Therefore, current procedures generally require contractors to notify the district of the same issue three times. In turn, district staff must respond each time, and we found the denials were generally for the same reason each time.

Current procedures are designed so project managers make initial decisions on whether to approve or deny a claim issue. Once an issue is submitted as a certified claim, the district administrator has the responsibility to respond to the contractor. However, we noted project managers generally involved and discussed claim issues with District Construction Engineers and/or District Administrators when the issues were first brought to their attention.

Since project managers generally involve district management from the outset of a claim issue, the current process creates more paperwork and a lengthier process for both district staff and contractors. The department should change its specifications to eliminate repetitive steps within the claim review process. Specific changes made to the current process should require only one submittal and response of a claim issue. Once this is done, negotiations can begin with the contractor earlier in the process to get the dispute resolved.

What Could a More Efficient Claims Process Look Like?

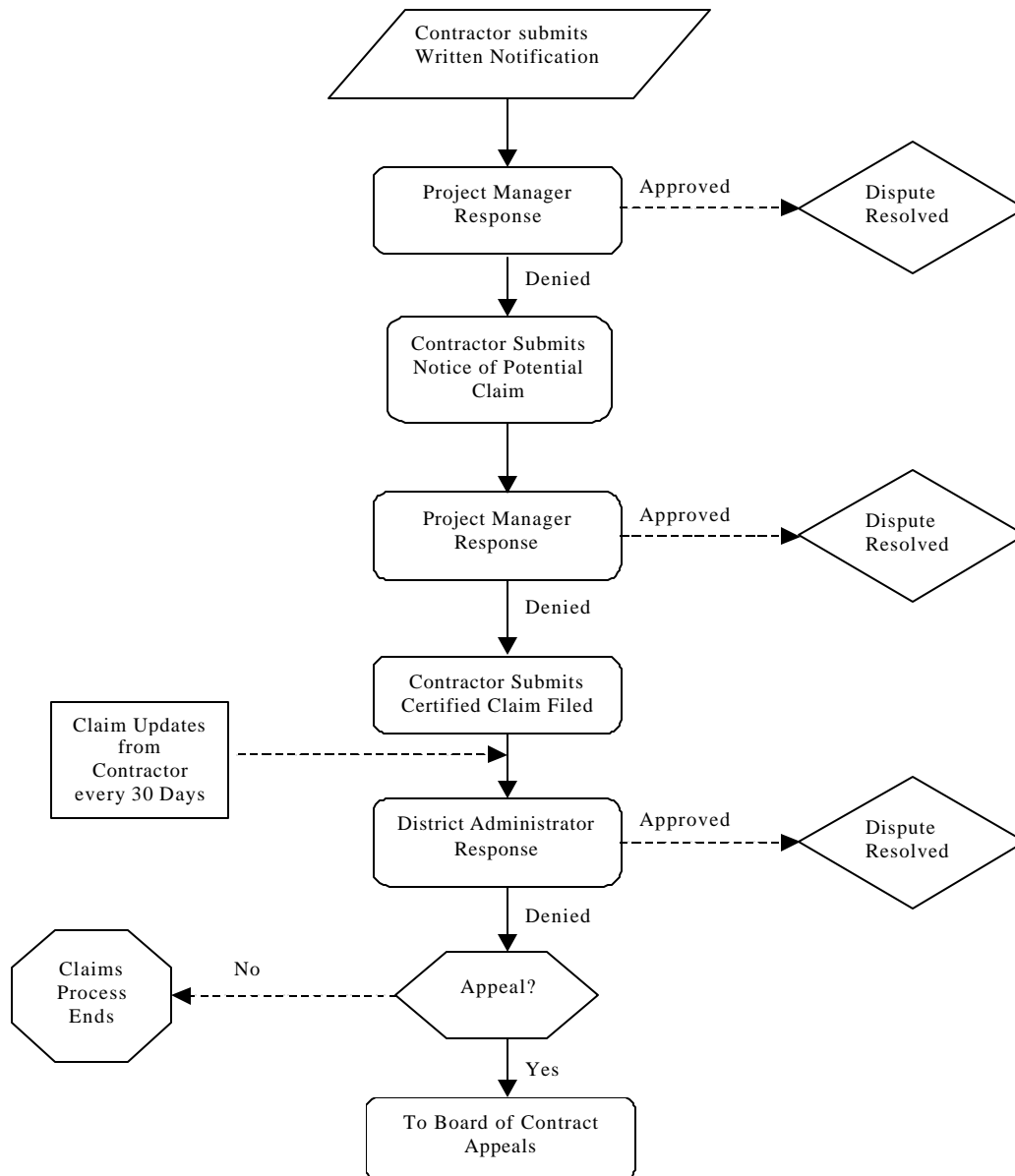
If the department were to eliminate repetitive steps from its claims process and redirect efforts towards negotiations with contractors, the claims process could become more efficient for the department and contractors. The following figures illustrate the efficiencies that

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could be achieved if unnecessary steps were eliminated and more emphasis placed on early negotiations with contractors. Figure 1 illustrates the MDT's current contract claims process. Figure 2 shows the efficiencies that could be achieved if repetitive steps were removed from the process.

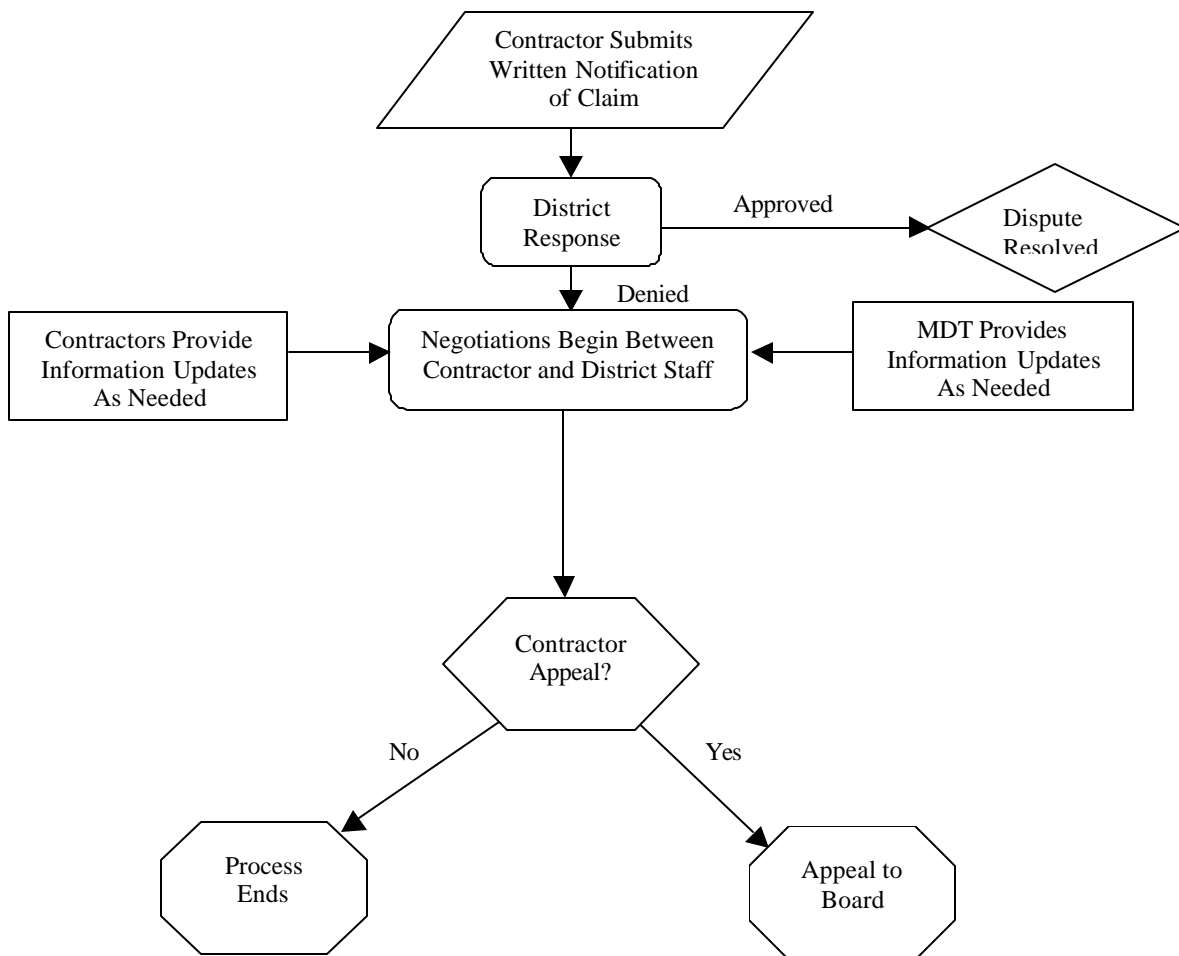
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Figure 1
Current Contract Claims Process



Source: Compiled by the Legislative Audit Division from MDT's Standard Specifications for Road and Bridge Construction.

Figure 2
Proposed Contract Claim Process



Source: Compiled by the Legislative Audit Division.

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Specifications Should Emphasize Negotiations of Claims

Claim processing requirements in the Standard Specifications for Road and Bridge Construction do not require negotiations between district staff and contractors on claim issues. The specifications, as illustrated in Figure 1, focus more on an exchange of paperwork and forms between contractors and district staff rather than discussions of the issue. Specifications appear to be set up more to deny claims rather than to have timely discussions in an attempt to reach fair settlements. According to the ASCE, the most effective way to resolve construction disputes is through negotiations. Negotiations take a significant amount of time and effort to gather necessary documentation and include phone discussions, correspondence, and meetings between district personnel and contractors. We noted specifications for other states we contacted focus on negotiations between contractor and department staff.

Even though negotiations are not discussed in the specifications, negotiations between contractors and district staff have occurred and contributed to the 130-day processing time for claims. We do not necessarily believe this time frame is out-of-line when negotiating claim issues with contractors. This is particularly true when timelines for claim settlement are compared to other states where the average claim settlement is an average of 180 days (which includes appeal reviews). The states we interviewed said the majority of this time is spent negotiating issues with contractors. Our file reviews noted negotiations with contractors tend to occur during the latter stages of the claims process (at the certified claim stage) and after districts already denied the issue twice. In some cases formal negotiations did not begin until after the certified claim was denied, so the claim had been denied three times.

Since negotiations often occur late in the claims process, the effectiveness of the claims process is reduced because an adversarial relationship has generally developed between the district and contractor. This makes negotiations and issue resolution between district staff and contractors more difficult. According to the ASCE, formal negotiations should begin early in the process because the

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more time that passes the larger the disagreements become and the more difficult it becomes to reach a settlement.

In contrast to the department's specifications, the construction manual stresses the importance for district staff to take the time necessary to "study and understand problems so as not to be rushed into bad decisions." It also stresses communication with contractors to ensure problems can be resolved and equitable solutions reached. This communication (i.e. negotiations) should begin as soon as a claim issue is identified. Rewriting the specifications to require negotiations with contractors at the beginning of the process instead of the end will help improve timeliness of district decisions and reduce the adversarial relationships that exist between districts and contractors.

Recommendation #2

We recommend the department improve its claim specifications by removing repetitive steps and focusing on early negotiations of claim issues with contractors.

Escrowed Bid Documents

Contracts for projects with engineer's estimates of at least \$3 million include a special provision that requires bid documents be placed in escrow within seven days of the bid opening. Bid documents include any information that contractors used to calculate unit prices when bidding on construction projects and includes "any writings, working papers, computer printouts, charts, and compilations, used by the contractor to determine the bid it submits." In the event a contractor files a claim on a project, the special provision allows the department to open and review the escrowed bid documents and use the information when negotiating the claim with the contractor. There are varying views regarding escrowed bid documents among transportation officials. Some believe the documents provide good information to assess the validity of a claim. Others do not believe the information necessarily helps negotiations to a great extent.

Bid Documents Assist in Claim Negotiations

According to the Federal Highway Administration, escrowed bid documents are a good source of information for parties to resolve

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disputes on an equitable basis. During our review, we identified an example that showed how bid documents can be valuable in negotiations with contractors and helped prevent the department from paying contractors additional compensation when they were not entitled to it. We reviewed one project where district personnel used the escrowed bid documents to negotiate with a contractor. The contractor submitted a claim for over \$300,000 to cover costs to develop a new gravel pit because the contractor did not have sufficient gravel to complete the project. However, when bid documents were reviewed the district found the contractor bid the job using the materials in the supposedly “new” pit. This resulted in this claim being dropped and the department avoided an additional cost of \$300,000 on the project.

Department Not Always Following Specifications Related to Escrowed Documents

Construction contracts state that if contractors do not submit all bid documentation to be placed in escrow it is considered a “material breach” of the contract and acts as a “final and total waiver” of all claims and disputes on the project. We identified instances where all bid documentation was not provided as required by the contract. For example, one claim we reviewed was for approximately \$250,000. When the department opened the escrowed bid documents they found that not all the documents had been provided. However, the department did not deny the claim. A decision on this claim was still pending after 15 months of dealing with the issue. Both parties believe this claim issue will need to ultimately be resolved by the court system. If the district had denied the claim upon discovery that the escrowed bid documents were missing, this issue could have been appealed to the courts much earlier in the process.

District staff said they are not comfortable denying claims just because escrowed bid documents are not provided. Their main concern is they do not believe the department is consistent in requiring contractors to submit bid documents to be placed in escrow. Additionally, MDT legal staff said they believe the courts would view a department denial of a claim based on a contractor not providing bid documents to be placed in escrow as a “procedural technicality.” Therefore, they do not believe the courts would

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support the department's decision to deny a claim for this reason. MDT legal officials are not aware of any instances where this has happened because a claim has not been challenged solely for this reason.

Review Value of Escrowing Bid Documents to Claims Process

In a prior recommendation we discussed the need for the department to focus on early negotiations of claim issues with contractors. Escrowed bid documents can be one source of information that can be used to negotiate some contract claim issues with contractors. However, we found the department is not always requiring contractors to provide all required documentation or denying claims when contractors do not provide required information. Department staff does not appear to fully support or understand the requirements of this specification. The department needs to review whether placing bid documents in escrow adds value to the department's ability to negotiate contract claims. If the department determines the value is limited, then the specification should be eliminated. If there is value to placing bid documents in escrow, then the specification should be rewritten to make it a more useful and effective tool for the contract claims process. In addition, a system should exist to ensure contractors provide required documentation to be placed in escrow.

Establish a Better System to Ensure Information is Provided

The department does not currently have an effective process to ensure contractors have submitted all bid documentation. The department requires contractors complete a checklist to show which bid documents were provided, but there have been times when the checklist was not completed. Additionally, department officials said there is no procedure in place to verify the information noted on the checklist is actually provided. The department could, at minimum, perform a spot check of the information when the contractor submits it to the department.

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Recommendation #3

We recommend the department review the value of placing bid documents in escrow and then:

- A. Eliminate the specification requiring documents be placed in escrow if their value is limited in negotiating contract claims, or**
- B. Establish a process to ensure all documents are provided when they are submitted to the department.**

Board of Contract Appeals

The Board of Contract Appeals (i.e. the board) becomes involved in the claims process when claims are denied at the district level. If contractors disagree with a district's decision to deny a claim, the decision can be appealed to the board. The board reviews the documentation related to the claim and the reason the district denied it. The board can uphold the districts decision of denial or modify the decision in whole or in part. Decisions of the board are the final step in the department's claim review process. If contractors disagree with the board's decision they can appeal the decision to district court. The department requested us to assess whether the board was making fair, unbiased decisions when evaluating claims. It also wanted an evaluation of potential alternatives to the board.

Board Operations Discussed With Contractors and Other States

We interviewed ten contractors regarding the ability of the board to make independent decisions regarding claims and found contractor's opinions were split. Three contractors believed the board provided an independent review, three did not, and four had no opinion due to a lack of experience with the board. Those that do not believe the board made independent decisions said an alternative process to appeal claim decisions should be established. We also discussed claim appeal procedures with other state transportation departments and found most states are moving away from using internal review boards. Other states were not necessarily making these changes because they believed their boards lacked independence. Rather, they were generally addressing the perception among contractors that their review boards were not independent.

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Alternatives are Available

Alternatives to the board are available. These alternatives include dispute resolution boards, mediators or arbitrators. However, information related to these alternative approaches found administration of alternative approaches can be more extensive and expensive than an internal review board. To further illustrate other alternatives, the following sections discuss dispute resolution boards and arbitration.

Dispute Resolution Boards

According to the ASCE's Construction Dispute Review Manual, dispute resolution boards (DRB) are generally assigned to oversee specific construction projects and consist of a three-member panel that is organized before construction projects begin. A DRB periodically meets at the job site where members become familiar with project procedures, specifications, and contract plans. The role of the DRB is to encourage early resolution of disputes and review those disputes that cannot be resolved. As part of its review process, the DRB reviews contract documents, correspondence, and any other relevant information and holds hearings so each party can explain its position and answer questions related to the issue. According to the Construction Dispute Review Manual, the fees for each DRB member generally range from \$1000 to \$2000 per day and complex cases could require hearings of several days and several weeks of DRB deliberations and report preparation. The approximate cost of the Board of Contract Appeals meeting we observed was approximately \$300 and there were several claims reviewed at this meeting.

Arbitration

Arbitration is a method where decisions are made by one or more arbitrators chosen by the parties involved. Decisions are based on facts and law. We discussed claim appeal procedures with officials from the Architecture and Engineering Division (Department of Administration) and the Water Resource Division (Department of Natural Resources and Conservation) for state building and dam construction projects. Appeals on these projects are reviewed through an arbitration process. Information from the American Arbitration Association indicates arbitration costs for construction

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reviews could be as high as \$16,000, per claim, depending on the size of the claim.

Summary

We evaluated decisions made by the board by attending a board meeting and reviewing documentation for several claims that were appealed to the board. The board reviewed five claims during the meeting we observed. The board was provided a detailed summary of each claim situation and all corresponding documentation for review. The board members were not directly involved in the district's decision-making process. Additional information was obtained from both contractors and district staff as needed. For the five appeals, the board upheld three district decisions for denial of the claim and reversed the district decision on two claims. We did not find evidence the board was making decisions that were not fair or were biased in any way. Additionally, if contractors do not agree with a decision made by the board, they can still take the issue to court.

The department's process to use an internal Board of Contract Appeals is working as intended and a change to an alternative approach is not warranted. If the department believes that the perception of independence is important and chooses to make a change, it needs to carefully consider the potential costs and administrative processes that exist with the alternatives.

Conclusion:

The Board of Contract Appeals works as intended.

Board of Contract Appeals Needs to Establish Review Timelines

We reviewed a total of 25 claims and 4 were appealed to the board. Based on our review of these appealed claims, we found the board took an average of 147 days to review these claims. Title 23, section 635.124 (b), Code of Federal Regulations, states "it is expected the state highway agencies will diligently pursue the satisfactory resolution of claims within a reasonable period of time." Furthermore, information from the American Society of Civil Engineers says board members should be provided time to review

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documentation related to claim appeals but hearings should be “held promptly after they are requested.”

Contractors who had experience with the board all expressed concerns regarding the board’s timeliness in reviewing claims. Contractors indicated these delays have significant impacts on their operations. According to the contractors, they simply want to know what the department’s final decision is on the issue. We noted other states generally reviewed claims in a more timely manner than MDT.

File reviews and interviews with department officials noted one reason for untimely board reviews was related to a personnel issue with an employee who was not referring claims to the board in a timely manner. A personnel change within the Construction Bureau addressed this issue. However, we noted other reasons for untimely reviews of claims by the board. In addition, department officials indicated it is often difficult to get board meetings scheduled due to other job duties and meetings of board members. Department officials also said board meetings are generally not scheduled until more than one claim can be heard, so months may pass until another claim is appealed.

The department’s specifications establish timelines for districts to review claims; however, the specifications do not require the board to review claims within any specified period of time. According to some board members, claim review and resolution has stalled because the board does not have timelines it must meet. Since there are no timeline requirements, claim review has not been made a priority for board members.

Board members suggested a variety of ways to ensure the board meets established timelines including meeting on a fixed date (such as monthly or quarterly), meeting at off hours to avoid scheduling conflicts, or having board members send representatives to other meetings so they can attend board meetings. We believe any of these methods would improve the timeliness of board reviews. However, any timelines that are established for board review should be

Chapter III - Contract Claims Administration

formalized in the department's Standard Specifications for Road and Bridge Construction. This change would also inform contractors of when they can expect final decisions on claims.

Recommendation #4

We recommend the department establish timelines for Board of Contract Appeal reviews within the department's Standard Specifications for Road and Bridge Construction.

Department Response



Montana Department of Transportation

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David A. Galt, Director
Judy Martz, Governor

March 11, 2003

Jim Pellegrini, Deputy Legislative Auditor
Legislative Audit Division
P.O. Box 201705
Helena MT 59620-1705

Subject: Performance audit of highway and bridge construction contract claims process

Dear Jim,

I'm sending you our reply to the audit recommendations for publication in the final report.

Sincerely,

David A. Galt
Director

attachment

copies: Joel Marshik, Chief Engineer
Dennis Sheehy, Internal Audit Unit Manager



Highway & Bridge Construction Contract Claims Process

Department response to Legislative Performance Audit recommendations

Recommendation #1

Establishing management information so claim activity and impacts can be evaluated.

We concur.

The Construction Bureau has instituted a spreadsheet application to track on-going claims in construction contracts. This is viewed as an interim measure until such time as the business plan required by the department of Administration is completed and approved for a database and tracking system. Also, the bureau is in the development stages of the AASHTO software module SiteManager. SiteManager has some capabilities that will be used in conjunction with the proposed database and tracking system. It is not fully determined at this time how these software management systems will be integrated.

Staff training in the area of claims mitigation and tracking is an on-going process. Training in this area was conducted in conjunction with the annual training academy, which took place at MSU in Bozeman this past January. In addition, training in plans and contract documents, project scheduling, change orders, and negotiations was made available at Bozeman, and will be continued on a regular basis. These subjects have relevance in the areas of claims. The importance of the documentation of claim issues is a subject being emphasized by the Claims Response Team. The Claims Response Team concept has been promoted and implemented by the Construction Review Section under the guidance of Paul Jagoda, PE, Construction Review Supervisor. This team is being deployed in response to all major claims, to aid district construction personnel with the proper handling and mitigation of major claims. The Claims Response Team attempts to make available all technical resources necessary for field personnel involved in claim issues.

The Construction Bureau is in the initial stages of analyzing claim data to determine the number of claims being filed on a statewide and district basis, reasons claims are being filed and claim cost and status. The Construction Bureau believes that less reliance on method specifications and moving towards end product specifications, which characterize the desirable characteristics of products, and reward the producer of superior quality products, is a key towards lessening conflict and resultant claims on projects. Towards this end, the bureau has promoted and led the effort in developing new specifications for plant mix surfacing, bridge piling, drilled shafts, seal and covers and other products. The end product

specification process removes MDT from the oversight of methods employed by contractors in production, and analytically focuses on what is being produced. This concept promotes contractor innovation and efficiency, and the adoption of new and improved equipment, methodology and materials.

The bureau is also involved in the streamlining and elimination of unnecessary submittals. This is being promoted for some of the same reasons as end-product specifications, but also to promote efficient and less time consuming contract administration. The submittal and approval process can sometimes also buy the department unnecessary liability, and claims exposure. Bridge Reviewer Mac McArthur, P.E., is the bureau's lead in this area.

Recommendation #2

Removing repetitive steps in the claim review process and focus on earlier negotiation of claims with contractors.

We concur with the encouragement of early negotiation.

The Engineering Division's Training Coordinator, Luella Schultz, in conjunction with the Construction Bureau, arranged and conducted training in negotiations in August 2002 for Construction Bureau engineering staff, and district construction and operations engineers. This initial training was well received, and it is anticipated that similar training will be provided to engineering project managers on an on-going basis in the future. Additional negotiation training was provided in January in Bozeman.

The Construction Bureau strongly endorses the idea that negotiation is a skill that can be developed through training, and would be extremely useful at the project level. The bureau endorses and promotes the resolution of problems and conflicts at the project level. It is dedicated to making all available department resources available to field project staff, so they have the essential technical information available to resolve issues.

We are in basic agreement with the audit recommendation to remove repetitive steps in the claims process, provided this does in fact encourage resolution at the project or district level. One concern is that unless the intent is properly conveyed, removing steps from the process could possibly be viewed as a method to escalate claims more quickly, rather than seeking mitigation at the lowest possible level.

Recommendation #3

Reviewing the value of placing bid documents in escrow and using these documents to negotiate contract claims.

We believe this specification should either be enforced or eliminated, with enforcement being our preferred alternative.

The audit report recommends either elimination of escrowed documents, or establishment of a process to ensure all documents are provided that are required by the specification. The Construction Bureau has on occasion recognized some benefit from escrowed bid

documents in the mitigation of claim issues. However, the specification's overall usefulness is questionable, given that it is not being enforced. Specifically, the specification contains the following language:

"Failure to submit all documentation and inventory as required above, or listed on the inventory documentation that is not actually provided as required, will be considered a material breach of the contract, is a failure to comply with a condition precedent to filing of a claim or lawsuit, acts as a total and final waiver of all claims or disputes involving matters that would have been included (e.g., claims of delay, changed site conditions, loss of productivity, etc.), and subjects the Contractor to action under ARM 18.3.101 et seq."

Bid documentation that has been reviewed has failed to meet the requirements of the clause on occasion, but this clause has not been used to reject any claim. The Construction Bureau believes that this clause may be viewed as an idle threat, and be routinely ignored in the future if some attempt is not made by the department to stand by these requirements. If that becomes the case, the value of bid documentation would be extremely suspect.

We should not continue to make a responsiveness determination on the specification if it is not enforced. If a responsiveness determination is not made on the specification requirements, the specification is moot at best. If a responsiveness determination is to be made based upon compliance with this specification, but the specification not enforced in practice it is possibly counterproductive to the concept of awarding to the lowest bidder.

Recommendation #4

Establishing timelines for Board of Contract Appeal review of claims.

We concur with this recommendation. The Construction Bureau is scheduling quarterly meetings in an effort to promote timely action on claims, while the specifications on timelines are under review. The Construction Bureau would also like to see time frames associated with all steps in the claims process; currently there are no timeframes required of district administrators for response to claims.